FINANCIAL MANAGEMENT

A Guide for Beekeepers

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FINANCIAL MANAGEMENT - WHAT IS IT?

Before embarking on a discussion of financial management I believe it wise to define what it is that we are talking about. For purposes of this disucssion we will define financial management as the acquisition and use of capital resources by a firm. The firm in this instance is your business of keeping bees to generate a profit. It is important to keep in mind that we are managing capital resources to generate a profit, for there are many other reasons for managing or mismanaging your capital resources. It is probable but highly unlikely that you have the objective of simply dispersing the earnings of capital resources previously accumulated by you or someone else.

It might be well to spend just a minute explaining what I mean when I say profit. This term, often ill-defined, is magic and mysterious to some and to others is as common and understandable as apple pie. Some persons in your business I am sure define profit as "something left over at the end of the year -- if I'm lucky." This type of an approach to financial management is the "beginning of the end" for many promising businessmen and typifies the financial mismanager. Any beekeeper who starts out with this concept of profit will indeed be lucky if there is anything left at the end of the year. Although profits are never guaranteed they are more likely to accrue to the manager who plans for them. The basic profit equation is so simple that a young enterpreneur selling lemonade for five cents a glass can define it as

$$\text{Profit} = \text{Income} - \text{Expenses}$$

yet a great many businessmen do not understand the powerful implications of this basic formula. Rewriting this equation as

$$\text{Profit} = \text{Units Sold}\,(\text{Price/Unit} - \text{Cost/Unit})$$

shows us that the profit you earn in your beekeeping business is dependent on only three factors.

1. Units Sold -- pounds of honey
   -- hives rented
2. Price/Unit -- $/pound
   $/hive
3. Cost/Unit -- $/pound
   $/hive

If the profits of your beekeeping enterprise do not meet your expectations it is due to one or more of these three factors. The power to control profit comes directly from understanding the effect of each of these factors has on profit.

The objective of this presentation is to develop an understanding of and a basis for financial management that will assist you in obtaining and using your capital resources in ways that will improve your chances of having "something left over at the end of the year." We will disucss the process of management, credit management, investment analysis, management of operating inputs, tax managment, and estate management. The discussion will by necessity be brief and it not intended as an in-depth presentation of the topics covered. I hope it will stimulate you to seek better ways to manage the capital resources you have invested in the bee business.

Process of Management
(Decision-Making)
(Tasks of Manager)

1. Set Goals and Objectives

   It is the goals and objectives of the financial manager that will guide the whole decision process. If you set a goal of earning 15% on the capital you have invested then each decision must be evaluated in light of this goal. Without a goal or objective it doesn't really matter what decisions are made.

2. Define Problems or Opportunity

   The need for a decision must be identified. If you as the the financial manager do not recognize problems or opportunities there is no need for a decision. The real difficulty here lies in separating the symptoms of a problem from its cause. Not being able to meet your note when it is due is like a child having a fever; it is a symptom not the problem. The problem lies much deeper and could have one or more causes -- poor cash planning, poor credit arrangements, uncontrolled or unexpected expenses, lower prices than expected, or any of a host of other causes.

3. Gather Information

   Data, facts, and other information must be assembled to resolve the problem or exploit the opportunity. Information needed may include:

   a. resources available
   b. alternative solutions
   c. resource requirements of each alternative
   d. external factors affecting the firm

4. Analysis

   Information gathered must be analyzed so the financial manager can estimate the consequences of each alternative solution. Analysis should be conducted with reference to the goals and objectives of the firm.

5. Synthesis

   Consider the results of your financial management in conjunction with other dimensions of your business (legal, community, family, etc.).

6. Decision

   After considering all relevant alternatives, you the financial manager must choose the course of action you plan to follow. Choice will depend upon your goals and objectives and how well each alternative measures up.

7. Action

   Implement and administer your decision.

8. Accept the Consequences

   Be willing and able to accept unfavorable outcomes as well as enjoy the benefits of more favorable outcomes. Know and accept the RISK associated with the alternative solution that you implement.

9. Continued Evaluation

   Things change:

   a. technology
   b. laws
   c. economic conditions
   d. personal situation

   A good financial manager continually evaluates previous decisions in the light of new information to determine if new courses of action are warranted.

In summary the process of management can be boiled down to:

1. Set your goals
2. Identify your problem
   (not symptoms)
3. Identify alternative solutions
   (without respect to consequences)
4. Determine consequences of alternative
   (in light of your objectives)
5. Choose best alternative
6. Implement your choice
7. Evaluate solution

Credit Management

Remember -- you are borrowing money to make money, not to buy a new truck. If by borrowing the money and using it you are unable to generate more income than the expenses you incur you probably shouldn't be borrowing it.

1. Selecting a Lender

   Your choice of a lender is basic to successfully managing your credit. The lender you select will depend upon a number of factors.

   a. Type of loan
      1) Long term
      2) Intermediate term
      3) Short term

   b. Terms of loan
      1) Interest
         a) remaining balance
         b) add-on
         c) discount
         d) variable
      2) Penalties and service charges
         a) prepayment penalty
         b) required stock purchase
         c) other service charges
      3) Repayment
         a) length
         b) type
            - Single payment
            - Partial payment (balloon)
            - Amortized
              - decreasing payment
              - even payment
            - Variable
      4) Size of loan
      5) Loan service
      6) Security required

2. Sources of Credit

   a. Commercial banks
   b. Insurance companies
   c. Merchant, etc.
   d. Farm Credit System
   e. Farmers Home Administration

3. Credit Guidelines

   a. Creditor looking for 3 things
      1) Character
      2) Collateral
      3) Capacity
   b. Present sound case
      1) Past record
      2) Plans for future
      3) Credit needs
      4) Impact of credit
      5) How you will repay
      6) Collateral he can use
   c. Shop for terms
      1) Low interest
      2) Reasonable repayment
      3) Good service
   d. Minimize number of creditors
   e. Meet yourpayments
   f. Anticipate your credit needs
      1) Investment
      2) Operating

Investment Analysis
(Capital Budgeting)

1. Investment Defined

   An addition of assets to the farm business that will generate a stream of cash expenses and receipts

2. Investment Opportunities

   a. Replacement of capital asset
   b. Adoption of cost reducing technology
   c. Expansion of output

3. Returns to be Measured

   a. Profit
   b. Income
   c. Net cash Flow!!!

4. Criteria for Valuing Returns

   a. Rate of return
   b. Payback period
   c. Present value

Cash Management
(Cash Flow Statement)

Proper cash management can mean the difference between success and failure of a promising business venture. The preparation of a cash flow statement is the beginning of good cash management.

1. What is it?

   The cash flow statement, also referred to as a "sources and uses of funds," summarizes all cash transactions affecting the business during a given period of time. There are two types of cash flow statements.

   a. Historical record (Cash account)
   b. Projection

2. What Can They Do?

   a. Historical cash Flows

      The inventory, balance sheet, and income statement are important tools for measuring the financial position and progress of the business. Many farm lenders, however, have experienced situations where a borrower has a good balance sheet and high farm income, but has difficulty meeting his financial obligations. Failure to meet financial obligations in a timely manner will have an unfavorable effect on his credit rating and general reputation in the community. In many cases this perplexing situation can be diagnosed and resolved by analyzing the cash flow of the business.

   b. Projected cash Flow

      A cash flow budget will help predict sources and uses of funds just as plans for crop or livestock enterprises predict requirements (labor, feed, seed, fertilizer, etc.) for those enterprises. A farmer would be in serious difficulty if he did not have money to buy feed when he needs it, pay taxes, pay hired help, meet loan payments, etc. The projected cash will enable you to:

      1) anticipate cash needs
      2) buy when prices are lowest
      3) invest excess cash funds
      4) arrange financing before "trouble" arrives
      5) plan financing to reduce costs of borrowing

3. What is Included?

   a. Cash operating expenses
   b. Cash operating receipts
   c. Complete debt transactions
      1) Principal
      2) Interest
      3) Loans proceeds

d. Capital sales
e. Capital purchases
f. Non-farm cash items
   1) Income tax
   2) Non-farm income or expense
   3) Living expenses

4. Who Should Prepare It?

All businessmen (and consumers) should prepare a cash flow of some sort. It can be a time consuming project but the pay-off is great. The amount of detail will depend upon the need for such information. It is generally recommended for:

a. beginning farmers
b. established farmers contemplating major changes
c. farmers carrying a heavy debt load
c. farmers with high risk or seasonal enterprises

Tax Management

Your tax management options are gone for 1975 but just beginning for 1976 if you are paying taxes on the cash basis. The taxes you should be most concerned about from an operational standpoint are real eatate and income taxes. We will discuss estate, inheritance, and gift taxes when we talk about estate management.

1. Objectives

Proper tax management has two rational objectives
a) Maximize after-tax income
b) Paying no more taxes than the law requires

Tax payers, for the most part, when considering taxes think in terms of minimizing taxes rather than maximizing income after taxes. They are probably doing the right thing because they are simply operating with objective number two. They are dealing with the question of taxes after the fact and there is nothing to do except minimize their tax burden.

Think about taxes the year around. Understanding and considering the tax effects of all your business decisions will enable you to manage from an after-tax viewpoint. Taxes are a business expense and should be a factor in all decisions. Make your decisions during the year to maximize income after taxes and then at the end of the year be sure that you pay the minimum taxes required by law. There should be no conflict between wise tax decisions and good management decisions. If you think there is you probably are kidding yourself about something.

2. Real Estate Taxes

Real estate taxes are a fact of life and there is very little you can do about them from a management standpoint except recognize them as an expense. Do not overlook the likelihood of increased taxes if you make major improvements in your real estate such as:

a. New buildings
b. Remodeling
c. New roofs
d. Tile your land
e. Remove hedge rows
f. Anything that increases the value of your property

There is no excuse for your real estate tax (or income taxes for that matter) burden to come as a surprise. Plan for them. Know where the money is going to come from before the taxes are due.

There is one area where you can make a little hay (or honey if you wish) and reduce your property tax liability, depending on your situation. Do not overlook having your land taxed on the basis of agricultural value if you own a number of acres and its current assessed value is based on use as a rural residence.

3. Income taxes

The amount of income tax you will pay will depend upon your level of "taxable income." Taxable income is dependent on gross income, personal exemptions, allowable personal and business deductions. Depending on how you calculate gross income and business deductions your income tax burden can vary significantly.

a. Methods for calculating tax

The law permits you to use one of two ways to calculate the income tax you owe.

1) Cash method
- income is taxed in year received
- expenses are deductible in year paid
- does not include inventory changes

2) Accrual
- income is taxed in year earned
- expenses are deductible in year incurred
- includes inventory changes

Because of its flexibility, convenience, and ability to "hide" income 98% of all farmers use the cash basis for tax reporting.

b. Opportunities for tax management

The laws, rules, and interpretations of the IRS code provide a number of opportunities for you to affect your income tax obligation. In general these opportunities lie in the following areas:

1) Shifting income or expenses

Farmers are subject to yearly income variation from yield and price flucuations and yet they fac highly predictable operating expenses, tax exemptions, and deductions. Reporting income on the cash basis gives farmers considerable opportunity to shift cash items from one year to another by simply varying the timing of their transactions.

2) Income averaging

This is another tool designed to reduce the impact of year-to-year flucuations of farm income. If your taxable income for a given year exceeds by more than $3000 your average taxable income for the preceding five years it might pay to use this feature of the IRS code.

3) Loss carryback or carryforward

The law permits you to use your "losses" to your advantage by shifting them backward or forward to reduce your tax liability in a profitable year.

4) Using capital gain provisions

This is a feature that, when used properly can, reduce the income taxes paid. The effect occurs because the law considers capital gain income and ordinary income differently. Without going into detail the advantage of "capital gains" income over ordinary income is that the tax rate on the former is 1/2 that of the latter.

5) Managing depreciation recapture

Several methods of depreciation are acceptable to IRS

a) straight-line
b) double-declining balance
c) sum-of-the digits

The latter two which accelerate the depreciation are permitted only on new property with a useful life of three or more years.

In addition to the regular depreciation determined by one of the above methods, a taxpayer may deduct 20 percent additional depreciation during the first year. To do this the asset must have a useful life of six or more years.

A considerable amount of tax managing can be done here.

a) salvage values
b) useful life
c) method of depreciation
d) additional first year depreciation

In addition a special benefit referred to as the "investment credit" is available to reduce your tax liability. This is not available every year, however, and you must keep yourself informed about two things

a) when in effect
b) amount of tax credit

Remember to manage your business from a tax standpoint throughout the year that will maximize your after tax income and then at the end of the year take advantage of law so you pay only the required minimum tax.